UNITED STATES DISTRICT COURT
DISTRICT OF RHODE ISLAND

HOTEL ON THE CAY TIME-SHARING
ASSOCIATION, INC.

v. C.A. No. 97-279-T

ARNOLD KILBERG, FAIRWAY
CAPITAL CORP., PARTICIPATION
MANAGEMENT CO., PARTICIPATION
SERVICES CORP., and JOSEPH LONGO, JR.

## **MEMORANDUM AND ORDER**

ERNEST C. TORRES, Chief Judge.

Hotel on the Cay Time-Sharing Association, Inc. (the "Association") brought this action to recover damages for what the Association alleges was misappropriation of fees and negligence arising from the management of a time-share resort. The defendants counterclaimed seeking reimbursement for funds they claim to have advanced in order to pay some of the resort's operating expenses.

The case was tried to this Court sitting without a jury; and, now, is ready for decision.

## **Findings of Fact**

After carefully considering the testimony of the witnesses and poring over the voluminous exhibits presented, I find the relevant facts to be as follows.

### I. Creation of the Time-Share Units

Protestant Cay is a small island in the United States Virgin

Islands that is owned by the Virgin Islands government. In 1964, the Virgin Islands government leased the entire island to Hotel on the Cay, Inc. ("HOTC") for a period of fifty years pursuant to what is known as the "ground lease." Since then, HOTC's leasehold interest has been assigned several times.

Until 1980, each successive lessee operated the island as a resort hotel. The resort included two buildings in which the hotel rooms and a restaurant were located, a swimming pool, tennis courts and surrounding beaches. Access to the island was provided by ferries owned by the lessee.

On August 5, 1980, Oliver Plunkett, who then was the lessee under the ground lease, filed a Declaration of Partial Leasehold Ownership Plan (the "Declaration"), converting the portion of the island consisting of the hotel buildings and the land on which they sat (the "time-share property") into 2,857 weekly time-share units, which Plunkett began selling to the public. Each unit entitled the owner to occupy a designated apartment during a specified week each year and to use the remainder of the island and its facilities (the "ground lease property").

The Declaration purported to create an Association, consisting of all unit owners, for the purpose of "operating, managing and maintaining" the time-share property "on behalf of all of the owners of time-share estates." (Pl.'s Ex. 9, ¶ 4.A.) The Association was given "all the powers and duties incident to the operation of the time-sharing vacation ownership." (Id. ¶ 4.B.) The Association also was charged with responsibility for maintaining and operating the time-share property, and it was vested with authority to raise the revenue needed to pay expenses. The Association was to be governed by a Board of Directors ("the Board") elected by its members. (Id. ¶ 6.)

The Declaration required the Board to prepare an annual budget based upon anticipated receipts and estimated common expenses for the next fiscal year. (Id. ¶ 7.A.) Upon adoption of the budget, the Association was supposed to assess each time-share owner for the owner's share of the common expenses in accordance with an allocation formula appended to the Declaration. (Id. ¶¶ 7.B., 1.D & Ex. B.) In addition, the Association was authorized to make special assessments for emergencies and other matters. (Id. ¶ 7.B.)

The Declaration states that assessments are made by delivering or mailing notice to members and that the assessments are "due and payable in advance ... on the same day each fiscal year." (Id.) It further provides that an owner who fails to pay any assessment referable to a unit is not entitled to occupy that unit "until all delinquent assessments have been paid" and that interest on unpaid assessments shall accrue at a minimum rate of ten (10) percent per annum. (Id. ¶¶ 7.D., 7.E.) In addition, the Declaration confers upon the Association a lien for unpaid assessments.

Generally, if a unit is transferred, the transferee is jointly and severally liable with the transferor for all unpaid assessments made prior to the transfer. (Id. ¶ 7.C.) However, when title is acquired as a result of a foreclosure, the new owner is not liable for assessments "pertaining to the former owner which became due prior to the acquisition of title," unless notice of the Association's lien "was recorded prior to the recording of the foreclosed leasehold mortgage." (Id. ¶ 7.G.)

Among the expenses for which the Association is responsible are the costs of maintaining and repairing the two hotel buildings and their furniture, systems and equipment. (Id. ¶¶ 8.A., 8.B., 3.C., 3.D.) In addition, the Declaration requires the Association to pay a percentage of the cost of maintaining the ground lease property "with the cost percentage to be agreed upon from time to time between the Association and the [ground lessee]." (Id. ¶ 3.F.) The Association also is obliged to pay a pro rata share of the rent due under the ground lease with the respective shares of the ground lessee and the Association to be determined "on the basis of the total assessments and other receipts of the Association for each year compared to the total receipts generated on the land covered by the Ground Lease." (Id. ¶ 11.)

The Association and the ground lessee never reached any agreement regarding apportionment of the cost of maintaining the ground lease property. Moreover, no evidence was presented regarding the annual receipts attributable to the time-share property or to the ground lease property before September 1, 1994, or after May 31, 1997.

Notwithstanding the provisions in the Declaration, the time-share owners did not formally organize the Association and take over management of the time-share property until June 1, 1997. Prior to that time, the entire island was managed by the ground lessee.

## II. Management of the Time Share Property

### A. The Legend Years

In 1991, Legend Resorts, Ltd. ("Legend"), a Rhode Island limited partnership, acquired approximately 1,300 time-share units that Plunkett and his successors had been unable to sell (the "inventory units"). Sometime before March of 1994, Legend also acquired what had been Plunkett's interest as lessee under the ground lease, but it is unclear from the evidence exactly when that acquisition was made.

Legend's only general partner was N.E.B., Inc., a Rhode Island corporation. Two of Legend's limited partners were the wife and sister-in-law of Benedetto Cerilli, N.E.B.'s president.

Legend financed its acquisition of the inventory units and the lessee's rights under the ground lease by borrowing $1.7 million from a group of four Small Business Investment Companies ("SBIC's"): Fairway Capital Corp. ("Fairway"), Monetta Capital

Corp. (“Monetta”), Wallace Capital Corp. (“Wallace”) and Richmond Capital Company (“Richmond”). Fairway was the lead lender and was controlled by Arnold Kilberg, an accountant and the principal in Arnold Kilberg & Co. While Kilberg held no office in Fairway and described himself merely as its “investment adviser,” it is clear that he had ultimate decision-making authority with respect to the conduct of Fairway’s business.

As collateral for the Fairway loan, Legend gave Fairway a security interest in the ground lease and the inventory units as well as an assignment of its rights to receive income from renting the inventory units to the public. Fairway also became a limited partner in Legend with a 20 percent equity interest.

Legend employed Earl Powell to manage the island resort. Powell resided on the time-share property and received all of the money payable to the Association including maintenance assessments made against the time-share units and sums received from renting units to the public. No assessments were made against the inventory units. Powell also received amounts payable to Legend, as the ground lessee, including income from beach chair rentals, ferry fees and other fees generated by facilities on the ground lease property.

By the end of 1993, Legend was in arrears on its loan payments, and it instructed unit owners to mail their maintenance fees to 99 Wayland Avenue in Providence, Rhode Island, an address that Legend shared with both Fairway and Monetta. Several months later, Fairway initiated foreclosure proceedings against Legend.

B. The PSC-PMC Years

In March of 1994, Participation Services Corporation ("PSC") was incorporated by John Dean, Fairway's attorney. The Legend loan and the security for it were assigned to PSC for "servicing ... for the benefit of the participants in said loans." (Pl.'s Ex. 36.) Joseph Longo, Monetta's president, became the president of PSC and Jeanine Bourassa, an employee of Arnold Kilberg & Co., became PSC's vice president and treasurer. (Id.) Although Longo and Bourassa also were PSC's sole shareholders, they held their stock in trust "for the benefit of the participants in the loans now or hereafter held by the Corporation." (Id.) Longo regularly consulted with Kilberg about the conduct of PSC's affairs; and, in 1997, when Longo resigned as president, Kilberg succeeded him.

Several months after incorporating PSC, Dean also incorporated Participation Management Corporation ("PMC"). PSC was PMC's sole shareholder, (see Pl.'s Ex. 37), Powell was its president, and Longo was its vice president. Shortly thereafter, Legend and PMC entered into an agreement turning over management of the "Hotel on the Cay" to PMC.

PMC retained Powell as the island's "on site" manager and he continued to perform the same duties that he had performed for Legend. He received revenue generated by the time-share property in the form of rental income for units rented to the public and maintenance fees paid by some time-share owners when they arrived at the "hotel." Maintenance fees paid by other owners were mailed to PMC's office in Rhode Island and deposited in a bank account there. Powell also received revenues generated by the ground lease property that consisted primarily of beach chair rental fees.

All of the money that Powell received was deposited in several Virgin Islands bank accounts that he maintained. Checks were drawn against those accounts to pay "hotel" expenses.

PMC managed the "hotel" from September 1, 1994 until May 31, 1997. During that period, PMC's sole source of income was revenue generated on the island. Much of it was derived from the time-share property. For example, PMC collected maintenance fees from time-share owners totaling $863,388.[1] No maintenance fees were assessed against the 1,300 inventory units owned by Legend because, according to PMC, efforts to collect would have been futile due to Legend's precarious financial condition.

PMC also received income from renting time share units to the public. It is impossible to determine the amount received because there is no evidence showing which units were rented or how much

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[1] The maintenance fees collected each year were:

| | | |
|---|---|---|
| 9/1/94 - 12/31/94 | -- | $ 44,992; |
| 1995 | -- | $277,485.28 |
| 1996 | -- | $387,765.39 |
| 1/1/97 - 5/31/97 | -- | $153,144.98 |
| | | $863,387.65 |

Defs.' Exs. K-N.

rental income was paid. All that is known is that, like its predecessors and the Association after it, PMC remitted seventy (70) percent of the rent received for each time-share unit to the unit owner and applied the remaining thirty (30) percent toward expenses of maintaining and operating the "hotel." It also adhered to the well-established policy of not remitting any rent to the owner of a rental unit against which there were delinquent assessments. Accordingly, no rental income was paid to Legend or PSC as holder of the security interest in Legend's right to receive rental income.

In addition to maintenance fees and rental income, PMC received several hundred thousand dollars from other sources. Some of that revenue (e.g., "beach chair income" and "ferry income") was generated by the ground lease property and rightfully belonged to Legend, or to PSC as its assignee; but some (e.g., "room income") apparently belonged to the Association. From the records presented, it is impossible to determine who was entitled to the rest of the money received by PMC because PMC's financial statements describe the receipts in vague and undefined terms such as "phone income" and "miscellaneous income." (<u>See</u> Pl.'s Exs. 88, 89.)

On the expense side of the ledger, PMC spent considerable amounts on ground lease payments, taxes, utility bills, employee salaries, maintenance and repair costs, and housekeeping supplies.

Again, in the absence of any breakdown or explanation, it is impossible to determine from PMC's financial statements which or how much of these expenses are referable to the time-share property and which or how much are referable to the ground lease property.

However, it is clear that at least some of the amounts paid by PMC were expenses incurred by Legend, PSC and/or Fairway that were unrelated to the management of the time share property. For example, PMC's financial statements show that $156,491.23 was paid for "legal and professional" expenses. It appears that some of that money was paid for bookkeeping and accounting services rendered to PMC by Arnold Kilberg & Co. but most of it was paid to John Dean, the Virgin Islands law firm of Isherwood and Isherwood, and attorney H.A. Curt Otto. Longo was unable to identify any legal work that any of those attorneys performed for PMC. On the contrary, the evidence shows that Dean and the Isherwood firm represented PSC and Fairway in connection with the Legend foreclosure. Indeed, Kilberg, himself, tacitly acknowledged that the legal fees were referable to the Legend foreclosure and attempted to justify their payment by PMC, saying: "if legal fees were necessary to be paid, just as they're necessary to be paid for our being here in this courtroom, someone has to pay them. And if Participation Management paid them, I don't see the difference between whether or not Participation Management paid them with its funds or whether the lender paid them with its funds because on either hand, either the loan balance goes up by the lender having paid the legal fees, or the loan balance doesn't go up, but Participation Management pays the fees."

In addition, PMC paid expenses for which responsibility was, at least, shared by parties other than the "Association." Thus, PMC paid Joyce Riccitelli's entire salary, even though she divided her time between PMC and Fairway. Similarly, PMC made payments on the ground lease despite the fact that, under the Declaration, the Association could not have been responsible for more than a portion of those payments.

PMC also issued checks to PSC and Fairway. However, the evidence indicates that most, if not all, of those amounts were repayments of advances made to PMC or reimbursements to PSC and Fairway for expenses attributable to operation of the time-share property that they had paid because PMC lacked funds. For example, there were occasions when PSC paid water and power bills attributable to the time-share units because PMC did not have sufficient funds to pay them and the utility companies had threatened to cut off service.

C. The Association Years

The first effort to organize the Time-Share Association was made early in 1995 while PMC was managing the resort. Frank Mina and several unit owners expressed concern that maintenance fees were not being collected for Legend's inventory units. They formed an “ad-hoc committee,” and began asking Powell and Kilberg for the names and addresses of all of the time-share owners so that they could convene a meeting. Those requests went unheeded until September of 1995 when Hurricane Marilyn struck and inflicted considerable damage on the island.

Because there was no insurance covering the losses, PMC sought a Small Business Administration disaster loan to repair the damage. Since only property owners or lessees were eligible for assistance, Longo convened the first annual meeting of the Time-Share Association in Providence on November 9, 1995. Around that time, the corporate charter of N.E.B., Legend’s general partner, was revoked.

At the meeting, the Association’s first Board of Directors was elected. PSC, as Legend’s “Attorney-in-Fact,” cast votes for the 1,300 inventory units owned by Legend. Those elected to the Board were Longo, Joyce Riccitelli (an employee of both PSC and PMC), Powell, Mina and Delores Astill, another time-share owner.

At a subsequent meeting, the Board defeated motions by Mina and Astill to begin assessing maintenance fees against the inventory units and to reimburse Association members for maintenance fees they had paid to PMC. In June of 1996, Longo, Riccitelli and Powell resigned from the Board, citing irreconcilable differences among the board members.

Shortly thereafter, Longo sent a letter, on PSC stationery, to time-share owners notifying them that special assessments of $325 per unit were being levied in order to repair the time-share buildings, the beach, one of the ferries, and the ferry docks. (See Pl.'s Ex. 64.) The letter directed that payment be made to PSC. Although Kilberg held no office in PMC, he and Longo made the decision to levy these assessments, and they made it without any authorization from the Board.

Some unit owners vehemently protested but were told that they would be denied access to their units if they failed to pay. Although PSC claims that some of the $97,900 collected was spent on repairs to the time-share property, it is unable to quantify or document those expenditures.

In April of 1997, the Association was formally incorporated, and it commenced this action. On June 1, it took over management of the time-share property. During each year since then, the Association has assessed maintenance fees against all time-share units, including the inventory units. The first assessments, for the year 1997, were made on August 19, 1997. The assessments against the inventory units for that year totaled $332,743. Subsequent assessments for 1998 and 1999 were made against the inventory units in the amounts of $332,215 and $387,133, respectively.

Neither Legend nor PSC has paid any of these assessments. For that matter, neither have thirty-eight percent of the other time-share owners, including Frank Mina, the association's former president. Therefore, in keeping with established policy, none of the delinquent owners received any rental income derived from their units.

On May 2, 1997, shortly before the 1997 assessment was made, PSC purchased all of Legend's interest in the "hotel" at a foreclosure sale, which was the culmination of the foreclosure proceedings initiated three years earlier. (See Pl.'s Ex. 21.) However, the "Order Confirming Sale" that was entered by the Virgin Islands Territorial Court on May 22, 1997 (the "May 22 Order") refers only to the inventory units and does not include Legend's interest in the ground lease. The May 22 Order also stated that PSC was entitled to immediate possession of the inventory units; and, although it provided for a sixty-day redemption period, the Marshal's "Certificate of Sale," which also was recorded on May 22 (the "First Certificate") recites that Legend had waived the right to redeem. (Id.)

Several months later, PSC apparently discovered that Legend's interest in the ground lease had been omitted from the May 22 Order. Accordingly, on September 16, 1997, PSC obtained an amended order which was the subject of a second Certificate of Sale (the "Second Certificate"). (Pl.'s Ex. 8.) The Marshal recorded the Second Certificate on April 29, 1998.

In 1998, approximately one year after the Association assumed management responsibility, the island was struck by Hurricane George. No evidence was presented regarding the extent of the damage, but there, still, was no insurance in place.

**The Claims and Counterclaims**

The plaintiff and the defendants have asserted numerous claims and counterclaims against each other based upon a variety of legal theories. Because the complaint fails, in some cases, to identify the particular defendant or defendants against whom each claim is asserted or to describe the precise nature of the claim; and, because the complaint makes interchangeable references to "defendant," "defendants," and specifically named parties, it is difficult to determine what claims are being made against which defendants. Those claims that can be identified and merit discussion may be summarized as follows:

1. That PSC, Fairway and Kilberg are liable for unpaid maintenance fees referable to the inventory units for the years 1994-99 totaling $2,968,260 **through June 1, 1999,** plus interest at $813 per day. (Comp. Count VII.; Letter from Rodio & Brown to Court of 12/8/99 [the "letter of clarification"], at ¶ 1.)[2]

[2] Count VII alleges only that PSC is liable for the year 1997. However, in its Post-Trial Memorandum and post trial "letter of clarification" the Association makes clear that it is asserting claims against Fairway and Kilberg for maintenance fees owed by Legend, and against PSC, Fairway and Kilberg for maintenance fees assessed against PSC. Since evidence was presented regarding the failure to pay those assessments and

2. That the “defendants” are liable for unlawfully collecting and converting annual maintenance fees assessed against individual time-share units. (Comp. Counts I and II.) In its “letter of clarification,” the Association alleges that the amount converted consisted of $156,489 expended for the defendants’ legal and professional expenses and $62,952 “borrowed” by PSC from PMC and never repaid. (Letter of clarification at ¶¶ 4-5.)

3. That the “defendants” are liable for unlawfully collecting and converting hurricane damage assessments in the amount of $97,900 . (Comp. Counts I and II.)

4. That, to the extent that Legend may be liable for any of the foregoing fees, Fairway, as a partner in Legend, also is liable because although Fairway was only a limited partner, under Rhode Island law, it waived the limitation on its liability by exercising control over Legend. (Comp. Count V.) In addition, the Association argues that Fairway became liable as a general partner in November 1995 when N.E.B.’s corporate charger was revoked.

5. That the “defendants” negligently failed to insure the time-share property against loss due to hurricanes. (Comp. Count IV.)

The counterclaims made by PSC and PMC are:

1. That the Association is liable to PSC and PMC for approximately $850,000 that PMC and PSC allegedly spent, over

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these defendants’ potential liability for that failure, the pleadings are deemed amended to conform to that evidence. See Fed. R. Civ. P. 15(b).

and above any maintenance fees that they may have collected, in order to “keep the hotel open” and to pay the Association’s share of payments due under the ground lease and the cost of maintaining the ground lease property. (CounterCl. Counts I and II.)

2. That the Association is liable to PSC and PMC for amounts received by the Association from renting the inventory units to the public.[3]

## **Conclusions of Law**

I. The Association’s “Standing” to Assert Claims That Accrued Prior to Its Incorporation

Since some of the Association’s claims pertain to events that occurred prior to its incorporation on July 25, 1997, (see Defs.’ Ex. LL), the Court questioned whether the Association was the proper party to maintain an action to recover on those claims.

In their post-trial memorandum, the defendants note that the Association “did not come into legal existence until July 25, 1997.” However, the defendants fail to provide any reasons or cite any authority that would preclude the Association from suing on claims of its members that arose before that time. While the Association’s memorandum is similarly lacking in citations to supporting authority, it does argue that the Association is

[3] This claim was not pled, but evidence was presented to support it; and, therefore, pursuant to Fed. R. Civ. P. 15(b), the counterclaim is deemed amended to include this claim.

entitled to pursue pre-1997 claims because it is the corporate successor of the original association. (See Pl.'s Post-Trial Mem. p.30.)

The defendants' failure to adequately brief this issue constitutes a waiver. See United States v. Dussault, 132 F.3d 30 (1st Cir. 1997); United States v. Dietz, 950 F.2d 50, 54 (1st Cir. 1991). Moreover, allowing the Association to assert these claims is consistent with the principle that a corporation that continues the business of an unincorporated entity, such as a sole proprietorship, may succeed to the rights of the unincorporated entity. See, e.g., Unruh v. Hale, No. 85-4464-C, 1989 WL 31411, *2 (D. Kan. March 23, 1989); R-C Motor Lines, Inc. v. United States, 241 F. Supp. 124, 127 n.2 (M.D. Fla. 1965); Hall Bros. Constr. Co. v. Mercantile Nat'l Bk. of Indiana, 642 N.E.2d 285, 286 (Ind. Ct. Apps. 1994). Therefore, the Court sees no reason to preclude claims arising from events that occurred before July 25, 1997.

## II. The Association's Claim for Unpaid Maintenance Fees re Inventory Units

### A. Liability of PSC as Owner

The Declaration makes each unit owner liable for "all assessments coming due during the period of ownership." (Pl.'s Ex. 9 at ¶ 7.C.)

PSC acquired ownership of the inventory units by foreclosing on the Legend loan. The foreclosure sale was conducted in May of

1997; and, as already noted, subsequent to the foreclosure sale, assessments were made against the inventory units for the years 1997-99. Those assessments were as follows:

| Year | Amount of Assessments |
|---|---|
| 1997 | $332,742.91 (Ex. 98 and 99) |
| 1998 | $332,214.77 (Ex. 100 and 101) |
| 1999 | $387,132.91 (Ex. 102 and 103) |
| TOTAL | $1,052,090.49 |

PSC maintains that it did not acquire title to the inventory units in April of 1998 when the Second Certificate of Sale was recorded. Accordingly, since the 1997 and 1998 assessments were made before that time, PSC disclaims liability for those assessments. PSC relies on Paragraph 7.G of the Declaration, which provides that a transferee who acquires title by foreclosure is not liable for assessments which became due before the acquisition of title unless a lien for those assessments was recorded prior to the mortgage. (Pl.'s Ex. 9 at ¶ 7.G.)

The parties have furnished very little assistance to the Court in determining precisely when, under Virgin Islands law, title to an interest in real property vests in one who purchases the property at a foreclosure sale. Although Virgin Islands law is less than explicit on the subject, its pertinent provisions can be summarized as follows. A mortgage may be foreclosed by bringing an equitable action and obtaining a Judgment of Foreclosure and Sale. V.I. Code Ann. tit. 28, § 351. That judgment is enforced by obtaining an execution against the property, pursuant to which the property may be sold by the Marshal, see V.I. Code Ann. tit. 28, § 534; V.I. Code Ann. tit. 5, §§ 484-487, subject to the debtor's right to redeem. See id. § 535. When the property is sold, the plaintiff may move for an order confirming the sale. V.I. Code Ann. tit. 5, § 489. If redemption is not made within six months after confirmation of the sale, the buyer, then, becomes entitled to a conveyance by the Marshal. V.I. Code Ann. tit. 28, § 497. The entry of an order confirming the sale is a prerequisite to conveyance by the Marshal and to the buyer's right to possession. Lucern Investment co. v. Estate Belvedere, Inc., 7 V.I. 275, 1969 U.S. Dist. LEXIS 4163, at *4 (D.C.V.I. March 4, 1969).

The flaw in PSC's argument is that it acquired title, at least to the inventory units, in May of 1997 when the First Certificate of Sale was recorded and not in April 1998 when the Second Certificate of Sale was recorded.

As already noted, the first order confirming the foreclosure sale was entered on May 22, 1997, and both it and the Marshal's First Certificate were recorded that same day. (Pl.'s Ex. 21.) Although those documents contain no reference to Legend's interest in the ground lease, they state that PSC was entitled to immediate possession of the inventory units and that Legend had waived its right of redemption. (Id.) Consequently, recording of the First Certificate vested title to the inventory units in PSC. Since the 1997 and 1998 maintenance assessments for the inventory units were assessed after that time, PSC is liable for those assessments and for the 1999 assessment.

B. Liability of Fairway and/or Kilberg

The Declaration makes "every" unit owner liable for its share of the Association's common expenses and for all assessments made with respect to its unit. (Pl.'s Ex. 9, ¶¶ 7.C., 2.C. & Ex.B.) Legend is not relieved of that liability for the portion of maintenance fees attributable to the inventory units merely because Legend and/or others managing the time-share property, failed to assess maintenance fees against those units. Although Legend is not a party to this action, Fairway and/or Kilberg may be accountable for those fees to the extent that they share in Legend's liability. They also would be accountable for any liability that they may share with PSC for the 1997-99 assessments.

1. Liability of Fairway

PSC's liability for the 1997-99 maintenance fees is shared by Fairway because PSC was nothing more than an instrument or alter ego of Fairway. PSC was created for the sole purpose of "servicing" the loan made to Legend by Fairway and the other entities for which Fairway acted as lead lender. The loan was assigned to PSC for no consideration and PSC was merely a conduit for collecting the amounts due and turning the payments over to Fairway. PSC conducted no other business, performed no other functions and had no other assets.

Moreover, Longo and Bourassa, an employee of Kilberg and Co., were PSC's only shareholders, and they held their stock in trust for the benefit of Fairway and the other lenders who had the power to divest them of their stock at any time. Indeed, Kilberg, himself, described PSC as Fairway's "alter ego." Accordingly, Fairway is jointly and severally liable with PSC for the 1997-99 maintenance fees assessed against the inventory units.

In addition, Fairway shares Legend's liability for that portion of the maintenance expenses attributable to the inventory units between November 28, 1995, when N.E.B.'s corporate charter was revoked, and the time that ownership of the units passed to PSC.

Under Rhode Island law, a corporation ceases to be the general partner of a limited partnership when the corporation's charter is revoked. R.I. Gen. Laws § 7-13-23(9). Revocation is deemed an event of withdrawal. R.I. Gen. Laws § 7-13-23(9). Since a limited partnership cannot exist without a general partner, <u>see id.</u> § 7-13-1(7), revocation of the lone general partner's corporate charter dissolves the limited partnership. <u>See id.</u> § 7-13-44(3).

Thus, Legend, as a limited partnership, was dissolved on November 28, 1995. By continuing to conduct Legend's business after that time, the former limited partners functioned as a general partnership, see id. § 7-12-17, and became jointly and severally liable for the partnership's obligations. See id. § 7-12-26. Therefore, Fairway, as one of the general partners, is liable for maintenance expenses attributable to the inventory units after November 28, 1995.

2. Liability of Kilberg

Although the Association presents a number of reasons why Kilberg should be held personally liable for some of the acts committed by some of the corporate defendants, it fails to make a convincing case for imposing personal liability for maintenance fees referable to the inventory units. In fact, it is difficult to decipher the Association's argument for imposing such liability.

Generally, the officers of a corporation are not personally liable for wrongful acts committed by the corporation unless they participated in or directed those acts. See Escude-Cruz v. Ortho Pharm. Corp., 619 F.2d 902, 907 (1st Cir. 1990); Banks v. Bowen's Landing Corp., 652 A.2d 461, 463 (R.I. 1995). By the same token, the principal of a corporation ordinarily does not incur personal liability for corporate misdeeds in which the principal did not participate unless the principal uses the corporate entity as a sham to "defeat public convenience, justify wrong, protect fraud or defend crime." Thompson Trading Ltd. v. Allied Brewers Overseas Trading, Ltd., 748 F. Supp. 936, 946 n.6 (D.R.I. 1990). In such cases, a court may "pierce the corporate veil." Id. Unfortunately, there is no bright-line test for determining when it is appropriate to disregard the corporate entity. Crane v. Green & Freedman Banking Co., 134 F.3d 17, 21 (1st Cir. 1997). Since such a decision runs counter to the rule of limited liability that the law recognizes as one of the advantages of doing business in the corporate form, it ordinarily requires a finding that the principal, himself, has disregarded the corporate form by failing to observe the necessary formalities of doing business as a corporation or by treating corporate assets as his own. See Hiller Cranberry Prods., Inc. v. Koplovsky, 165 F.3d 1,4 (1998).

Here, the Association has failed to present any evidence that Kilberg participated in the decision not to assess maintenance fees against the inventory units or that the decision was the product of a fraud engineered by Kilberg. Nor has the Association shown that Kilberg and either PSC or Fairway were, in reality, one and the same.

3. Measure of Recovery

The share of the maintenance expenses attributable to the inventory units for the years 1997-99 is easy to determine. They are reflected in the assessments of $332,742 for 1997; $332,214 for 1998; and $387,132 for 1999, (See Pl.'s Exs. 98-105), for which both PSC and Fairway are liable. In addition, under Paragraph **7.E** of the Declaration, the Association is entitled to recover interest on unpaid assessments at the rate of 10% per year.

Calculating the maintenance expenses attributable to the inventory units between November 28, 1995 and 1997 is a more difficult task because no assessments were made against the inventory units during that period. The Association argues that it is entitled to recover an amount equal to the number of inventory units multiplied by the per unit assessment made against the non-inventory units for 1995 and 1996. However, since the maintenance expenses for those years were determined and allocated among the other unit owners, the Court finds that the amount to which the Association is entitled should be calculated by determining what portion of the total maintenance fees assessed for 1995 and 1996 properly were allocable to the inventory units. Stated another way, the Association is entitled to those portions of the 1995 and 1996 maintenance expenses that would have been billed to Legend if the inventory units were assessed and that, instead, were absorbed by the other time-share owners in the form of higher assessments against their units.

There is no need to make that calculation for 1995 because the Association has failed to establish that Fairway bears any responsibility for 1995 maintenance expenses. Under the Declaration, a unit owner's obligation for maintenance expenses arises at the time of assessment, (Pl.'s Ex. 9, ¶¶ 9.B and 7.C.), which is made by delivering or mailing notice to the owner. (Id. ¶ 7.D.) Here, there is no evidence that the 1995 assessments were made prior to November 28, 1995, the date on which Fairway became a general partner in Legend, and, therefore, liable for Legend's obligations.

With respect to the 1996 maintenance expenses, Fairway is liable for Legend's share because they became due and payable after November 28, 1995. Computation of that share begins with the fact that PMC's financial records indicate that it collected $387,765.39 in maintenance fees in 1996. (Pl.'s Ex. 87.) The approximately 1,300 inventory units for which the Association seeks to recover maintenance fees represents 42 percent of the 2,857 time share units. Therefore, Legend's (and Fairway's) share of the 1996 maintenance expenses is $162,869.61. That sum also bears interest at the rate of 10 percent per annum.

III. The Association's Claim for Conversion of Maintenance Fees Collected From Members

The tort of conversion occurs when one intentionally takes personal property belonging to another without legal entitlement or the owner's consent and exercises dominion or control over the property that seriously interferes with the owner's right to possession. DeChristofaro v. Machala, 685 A.2d 258 (R.I. 1996);

Fuscellaro v. Industrial Nat'l Corp., 368 A.2d 1227 (R.I. 1977).[4] The measure of damages for conversion is the market value of the property at the time of conversion. Jeffrey v. American Screw Co., 201 A.2d 146, 150 (R.I. 1964).

The evidence shows that, between August 31, 1994, when PMC began managing the time-share property, and May 31, 1997, when the Association took over management, PMC collected approximately $863,000 in maintenance fees from the time share owners. PMC had no authority to collect those assessments because, under the terms of the Declaration, the power to assess and collect maintenance fees was vested in the Association. (Pl.'s Ex. 9 at ¶ 7.B.)

However, the evidence also shows that, during the same period, PMC paid nearly $3 million for expenses of operating the time-share property and its facilities and/or the ground lease property and its facilities. In any event, the Association seeks to recover only $156,491.23 that PMC paid for legal and professional fees.

It is clear that virtually all of these fees relate to PSC's efforts to foreclose on the Legend loan or to other matters bearing no relationship to the operation of the time-share property. Most of the money was paid to John Dean and the law firm of Isherwood and Isherwood, both of whom represented PSC and Fairway in

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[4] There appears to be no Virgin Islands law specifically on conversion. However, Virgin Islands courts follow the "rules of the common law, as expressed in the restatements of the law approved by the American Law Institute, and to the extent not so expressed, as generally understood and applied in the United States." V.I. Code Ann. tit. 1, § 4 (1999).

connection with the Legend foreclosure, and to attorney H.A. Curt Otto. Longo was unable to identify any legal work that any of them performed for PMC.

Nevertheless, the evidence does not support the conclusion that those fees were paid from the maintenance fees received from the time share owners. PMC also received considerable revenues from the ferry service, beach chair rentals and other activities on the ground lease property, that were more than sufficient to pay the fees in question, as evidenced by the $3 million in expenses that it paid during the period in question.

The Association also seeks to recover $62,952 that it alleges was borrowed from PMC by PSC and never repaid. (See Pl.’s Post-Trial Mem. p.47.) This claim assumes that all of PMC’s funds were derived from revenue generated by the time share property belonging to the Association. However, as already noted, PMC also received substantial sums from activities on the ground lease property.

In addition, the evidence shows that the amounts paid by PMC to PSC were not loans. Rather, they were reimbursements for sums that PSC had advanced to PMC or remitted to creditors in order to pay various expenses of the time share property that PMC lacked the funds to pay. For example, the evidence shows that PSC provided the money to pay some of the utility bills presumably attributable to the time share property.

In short, the Association has failed to present evidence sufficient to support its claim that the defendants converted maintenance fees.

## IV. The Association’s Claim for Conversion of Hurricane Damage Assessments

The parties have stipulated that PMC collected $97,900 from various time-share owners for the stated purpose of repairing damage done by Hurricane Marilyn. As previously stated, those assessments were made over the protests of the time-share owners and without authorization from the Association’s Board of Directors. Moreover, the amounts collected were deposited into PSC’s bank account and none of the defendants can account for how that money was spent.

Since PMC had no right to make the assessments and PSC had no right to collect the money, both of them are liable for conversion. Furthermore, because Kilberg and Longo directed that the assessments be made, they, personally, share that liability. See Banks, 652 A.2d at 463. Thus, all four of these defendants, and Fairway, for which PSC acted as an alter ego, are jointly and severally liable to the Association in the amount of $97,900.

## V. The Association’s Claim for Negligent Failure to Obtain Hurricane Insurance

The Association claims that the “defendants” are liable for negligently failing to obtain hurricane insurance that would have covered the losses inflicted by Hurricane Marilyn. In order to prevail on that claim, the Association must prove that the "defendants" had a duty to obtain such insurance, that they failed to exercise reasonable care or diligence in seeking to obtain it and that such failure was the proximate cause of the damage or loss that the plaintiff claims to have sustained. Turbe v. Government of the Virgin Islands, 938 F.2d 427, 428 (3d Cir. 1991); Restatement (Second) of Torts § 281. Here, the Association has failed to prove any of these things.

The Association is unable to point to any duty owed by the "defendants" to obtain hurricane insurance. On the contrary, the assertion of such a duty is inconsistent with the Association's position that the defendants lacked authority to exercise management authority over the time-share property. In addition, both the management agreement between PMC and Legend and the security agreement between Fairway and Legend required Legend to carry adequate insurance on the property, (Pl.'s Ex. 44, p. 5 at ¶ 8.1; Defs.' Ex. II, § 4(g) at p. 8.), and the evidence shows that both Kilberg and Longo demanded, on several occasions, that Legend obtain hurricane insurance.

Nor is there any evidence that the failure to obtain hurricane insurance violated any established standard of care. Although Mina testified that he knew of another resort that, at one time, had hurricane insurance, that evidence is insufficient to show that the

“Hotel” could have obtained such insurance at the time of Hurricane Marilyn or that the failure to do so constituted negligence. Indeed, the Association’s argument is undermined by its own failure to obtain hurricane insurance during the time that it has managed the “Hotel.”

## VI. The Defendants’ Counterclaim for Money Spent to “Keep the Hotel Open”

PSC and PMC seek to recover approximately $850,000 that they allegedly spent, over and above any maintenance assessments that they may have collected, in order to “keep the hotel open” and to pay the Association’s share of amounts due under the ground lease and the costs incurred in maintaining the ground lease property.

In making that claim, PSC and PMC have failed to distinguish between the expense of maintaining and operating the time-share property which was the Association’s responsibility and the expense of maintaining and operating the ground lease property which was the responsibility of Legend or PSC, as lessees under the ground lease. Thus, the defendants’ counterclaim includes amounts expended for replacement of one of the ferries, repairs to the ferry dock, maintenance of the pool, pool supplies, ferry insurance and taxes on the ground lease property paid to the Virgin Islands government.

It is true that such payments conferred an indirect benefit on the Association. If the taxes had not been paid, the time-share owners could have lost the use of their units. Similarly, if the ferry expenses had not been paid, the time-share owners could have been deprived of access to their units; and, if the expenses of maintaining the swimming pool and other facilities had not been paid, the time share owners could have lost the use of those facilities. Nevertheless, those payments were not chargeable to the time-share owners; and, therefore, are not recoverable by the defendants.

The claims for the "Association's share" of the cost of maintaining the ground lease property and its facilities and for the "Association's share" of the ground lease payments stands on a somewhat different footing. The Declaration gives the time-share owners the right to use the facilities located on the ground lease property, and it makes the Association responsible for a portion of the cost of maintaining that property and those facilities. (Pl.'s Ex. 9, ¶3.F.) However, the Declaration also provides that the Association's share of those expenses shall be "the cost percentage to be agreed upon from time to time between the Association and the [ground lessee]." (Id.) Since it is undisputed that no such agreement ever was reached, it is impossible to calculate the Association's share of those expenses for which evidence has been presented.

The Declaration also makes the Association responsible for its pro rata share of payments made under the ground lease. It provides that the Association's share "shall be determined on the basis of the total assessments and other receipts of the Association for each year compared to the total receipts generated on the land covered by the Ground Lease (including Association receipts, restaurant and lounge receipts and recreational facilities receipts)." (Id. ¶ 11.)[5]

There is no evidence showing how much the Association received before September 1, 1994, or after May 31, 1997. However, voluminous records were presented establishing that during that period, PMC had "Association receipts" of $863,387.66 for maintenance fees, (Pl.'s Exs. 85-87, 87A, Defs.' Exs. K(1), L(1), M(1), N(13)), and $913,047.66 in net income from unit rentals (Defs.' Exs. K(1), L(1), M(1), N(13)), for a total of $1,776,435.20.

It also is a fairly simple matter to ascertain some of the receipts generated on the ground lease property during that same period in question. The parties agree that PMC received $74,858 in beach chair rentals and $293,400 in ferry fees or a total of $368,258. (See Pl.'s Post-Trial Mem. at 5-6, Defs.' Post-Trial Mem. at 7-10.)

It is more difficult to determine whether the additional income recorded in PMC's records should be classified as

[5] As read in the Declaration, "land covered by the Ground Lease" refers to the entire island and includes both the "time share property" and the remaining "ground lease property."

“Association receipts” or receipts generated by the ground lease property. That income is rather vaguely described as “cruise income,” “energy income,” “exchange income,” “miscellaneous income,” “phone income,” conference room “rental income,” “ferry passes,” and “wholesale income,” and totals $368,515,60. (Defs.’ Exs. K(1), L(1), M(1), N(13).) However, since the defendants, themselves, assert that these revenues are attributable to the ground lease property, they will be included in making that calculation.

Accordingly, the Association’s pro rata share of the ground lease payments for the period from September 1, 1994 and May 31, 1997 is obtained by dividing the “Association receipts” ($1,776,435.20) by the receipts generated on the entire island ($2,513,208.80). That quotient equals 70.68 percent.[6]

PMC’s records and canceled checks establish that, during the period in question, $115,750 in lease payments were made to the Virgin Islands government. (See Defs.’ Exs. F, L(9), M(9) & N(3)-N(5) as summarized in Defs.’ Post-Trial Mem. p.3.) Thus, PMC is entitled to recover 70.68% of that amount, or $81,812.10, from the Association.

## VII. The Defendants’ Counterclaim for Rental Income from the Inventory Units

[6] The $2,513,208.80 figure is derived by adding the $368,258 in revenues generated by the beach chair rentals and ferry fees and the $368,515.60 generated by other ground lease property sources to the $1,776,435.20 in “Association receipts.”

PSC claims that it, as Legend’s assignee, is entitled to amounts received from renting the inventory units during the time that they were owned by Legend. That claim fails for several reasons.

First, PSC is unable to document the amount of rental income allegedly received from the inventory units even though PMC was managing the time-share property during most of the period in question.

More importantly, PSC ignores the fact that Legend was not entitled to any rents received for the inventory units. The Declaration provides that time-share owners who have not paid all delinquent assessments are not entitled to occupancy of their units. (Pl.’s Ex. 9, ¶ 7.D.) That provision resulted in the establishment of a policy that owners who were not current in paying their assessments were not entitled to income derived from renting their units. That policy was applied consistently by management and was adhered to by PMC, itself.

It is true that formal assessments never were made with respect to the inventory units. However, the assessments were simply a reflection of an owner’s liability for its share of the common expenses; and, as already noted, Legend was not relieved of that liability simply because it and/or PMC unjustifiably failed to make assessments against the inventory units.

Stated another way, during the period in question, Legend was delinquent in paying its share of the maintenance expenses; and, therefore, was not entitled to the rental income generated by the inventory units. Moreover, since PSC, as Legend's assignee, acquired no greater rights than Legend possessed, PSC was not entitled to that income either.

## **Conclusion**

For all the foregoing reasons, the clerk is directed to enter judgment as follows:

1. In favor of the Association against Fairway Capital Corp. for unpaid 1996 maintenance fees in the amount of $162,869.61, plus interest from the date of assessment at the rate of ten percent per annum.
2. In favor of the Association against Fairway Capital Corp. and Participation Services Corp., jointly and severally, for unpaid 1997-1999 maintenance fees in the following amounts:
   a) For 1997 maintenance fees -- $332,742.91 plus interest from the date of assessment, at the rate of ten percent per annum.
   b) For 1998 maintenance fees -- $332,214.77 plus interest from the date of assessment, at the rate of ten percent per annum.
   c) For 1999 maintenance fees -- $387,132.91 plus interest from the date of assessment, at the rate

of ten percent per annum.

3. In favor of the Association against Participation Services Corp., Participation Management Co., Fairway Capital Corp., Arnold Kilberg, and Joseph Longo, Jr., jointly and severally, for conversion of the hurricane damage assessment, in the amount of $97,900 plus statutory interest from June 28, 1996.
4. In favor of Participation Management Co. against the Association in the amount of $81,812.10 for reimbursement of ground lease payments.
5. All of the remaining claims and counterclaims are denied and dismissed.

IT IS SO ORDERED,

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Ernest C. Torres

Chief United States District Judge

Date: , 2000

TABLE OF CONTENTS